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The Conference Board

Worldbusiness Perspectives No. 82
October 1984

WORLD TRADE
Reversing the Decline

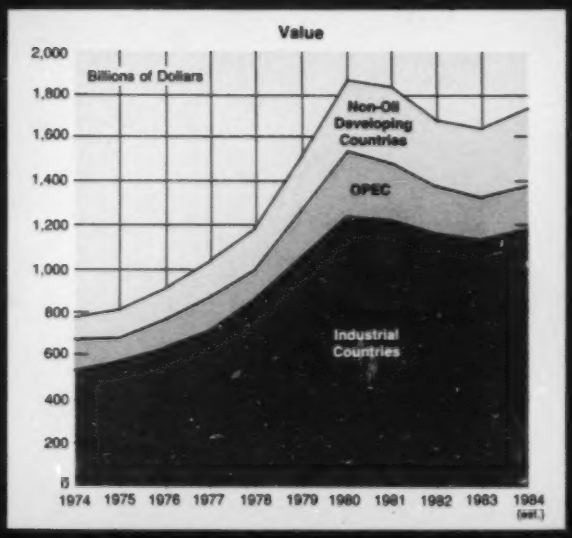
In 1983, the value of world trade, measured in U.S. dollars, declined for the third consecutive year. The decrease, of about 2 percent, was more moderate than in 1982. Still, world trade contracted by more than 10 percent for the entire 1981-1983 period, during which the world economy was plagued by the severest recession since the 1930's.

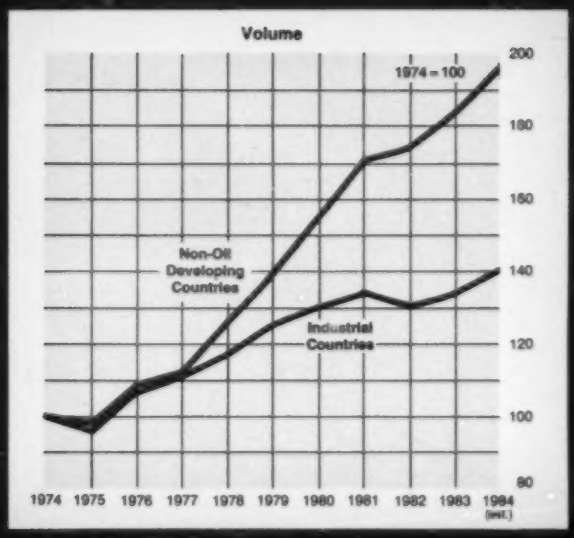
Part of this decline in value is, of course, attributable to the sharp rise in the dollar against other currencies over this period. The dollar appreciation automatically reduced the value of other countries' exports, when translated into dollars. (The strengthening dollar similarly tended to boost the U.S. share of world trade, in dollar terms.) In volume terms, world trade rose by 2 percent last year, following two years of virtual stagnation.

The most striking trend over this period, according to data developed by the International Monetary Fund (IMF), was the drastic reduction in trade imbalances, both for major areas relative to the rest of the world and among them, that had prevailed in 1980 and 1981. The most noticeable of these shifts was a narrowing of OPEC's trade surplus from $166 billion in 1980 to $36 billion in 1983, as oil shipments fell in both volume and value. Correspondingly, the industrial countries' trade deficit with OPEC declined from about $135 billion to $41 billion, and that of the so-called nonoil developing countries from $48 billion to $33 billion.

The second major shift in trade imbalances occurred between the latter group and the industrial countries. Sharp cuts in the imports of non-OPEC developing countries, mainly as a result of austerity programs instituted to cope with their debt burden, narrowed the industrial countries' trade surplus with that group from $45 billion in 1981 to only $7 billion in 1983. At the same time, a dramatic rever-

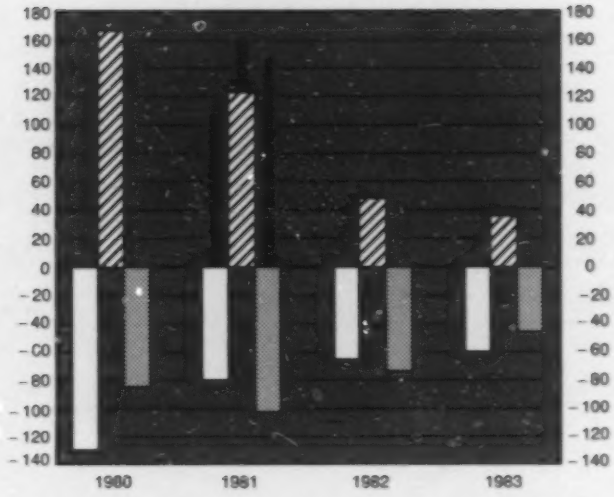
Growth of World Exports





Trade Balances by Major Areas

(Billions of Dollars)



sal occurred for the Latin American countries, which last year recorded a $10-billion trade surplus with the rest of the world—entirely because of the austerity measures taken by Argentina, Brazil and Mexico.

The general decline in world trade in recent years had little effect on the Asian countries, whose trade grew at a relatively steady pace, of about 13 percent, during 1981-83.

Trade and Economic Activity

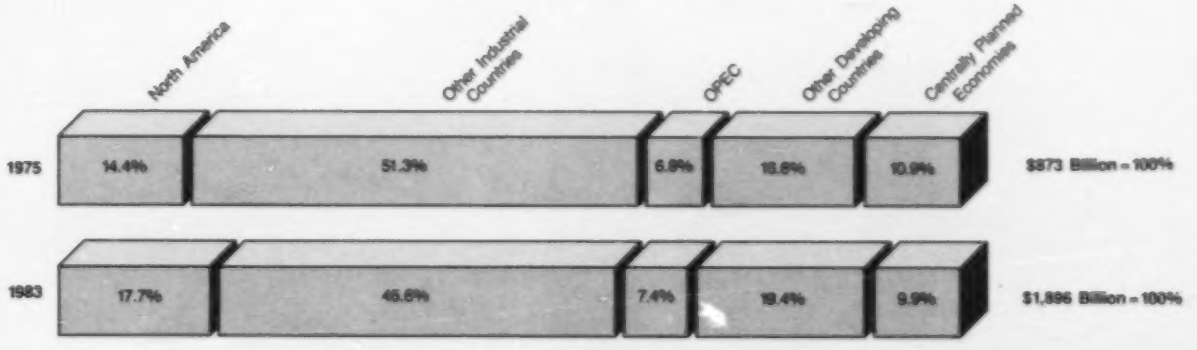
As already indicated, some of the major shifts in international trade over the past few years have mirrored the ups and downs in economic activity in the major trading countries. Conversely, trade itself can be a dynamic source of economic growth. From 1950 through 1975, for instance, the industrial countries' merchandise trade grew at an average annual rate of 8 percent, thereby contributing to an average annual growth rate of 4 percent for these economies.

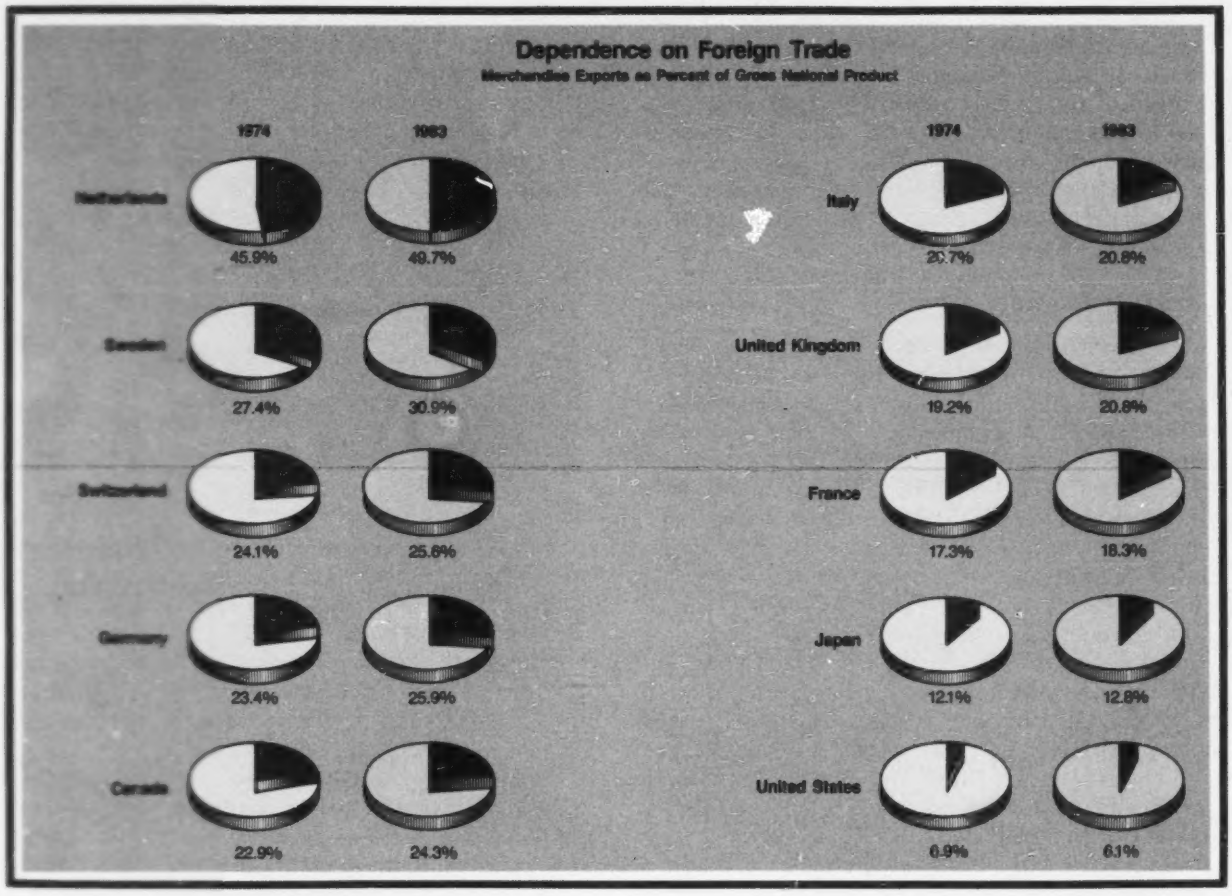
There is, in fact, an accelerating feature in the relation between trade and growth, since imports generally are highly responsive to growth in incomes. It has been estimated that if economic activity within the OECD (the group of the world's 24 major industrial countries) is rising by more than 1.5 to 2.0 percent annually, those countries' nonoil imports will grow about three times as fast. When annual growth for the group falls below 1.5 percent, trade tends to decline by a multiple of such slow growth. And when OECD growth is flat, nonoil trade declines by about 5 percent. This negative spiral was very much in evidence during the 1981-1982 recession, leading some observers to recall the sharp shrinkage of world trade during the Depression of the 1930's.

But the link between trade and economic activity has also been operative in the current economic recovery. Between the fourth quarters of 1982 and 1983, the volume of industrial countries' imports rose by 11 to 12 percent. Much of this impetus to world trade came from fourth-quarter-to-fourth-quarter increases of 24 percent and 34 percent, respectively, in the imports of the United States and Canada, which in that sense acted as "locomotives" for world recovery. But a 9 to 11 percent growth in import demand in Germany, Italy, Japan and the United Kingdom also contributed. Given the current projections for continuing favorable economic activity in 1984, import demand in the industrial world is expected to remain strong. Overall, the volume of world trade is estimated to rise by 5.5 percent this year and by a similar amount in 1985.

Perhaps one of the most encouraging developments of 1983-1984 has been the resumption of fairly strong growth in the export earnings of the nonoil developing countries, a trend that is crucial to the eventual resolution of many of those countries' debt problems. In 1983, the combination of a strong economic upswing in the industrial world and the upward movement in commodity prices led to a 12-percent increase in those countries' export earnings from industrial countries. The prospective continuation of relatively strong economic activity among

Destination of World Exports, 1975 and 1983





the latter group in 1984, the IMF noted in its date 1984 *World Economic Outlook,* points to a period "when external adjustment in the developing world can take place within a somewhat more favorable environment."

The Role of the United States

While the United States occupies the key spot in this environment of renewed trade expansion, it is interesting to note that its position has nevertheless declined, mainly as a result of the strong dollar. In fact, the proportion of total U.S. output that is exported—which is about one-half the ratio for Japan, one-third that for the United Kingdom, and one-fourth that of Germany—is now smaller than ten years ago.

Over the past four years, moreover, the U.S. share of world exports of manufactured goods has fallen by more than 25 percent in volume terms, a decline that was much sharper than the 12.5 percent drop in domestic manufacturing output as a whole. Yet, as an August 1984 New York Stock Exchange study, *U.S. International Competitiveness: Perception and Reality,* has shown, in 1982 fourteen out of forty U.S. industry groups held world export shares of between 15 and 35 percent, while another thirteen groups accounted for between 8 and 15 percent of world exports of those industries. Comments the study: "Once again, the data appear to contradict the notion that across the board U.S. industry cannot hold its own in world markets."

At the same time, the surge in U.S. imports has boosted the share of the United States in imports of manufactures by all OECD countries from 17 percent in 1970 to almost 23 percent last year. Given the extremely sharp increase in U.S. manufactures imports during January-July, the ratio may be even higher this year. At the same time, the import share of the U.S. domestic market held by manufactured goods has more than doubled since 1970, from 8 percent to a little under 19 percent. (Similar, although somewhat smaller, increases have also occurred in the case of the European Community and Japan.)

Again, however, the picture is by no means clear-cut across the entire industry spectrum. As the Stock Exchange study points out, over the 1972-1982 period, import penetration actually fell for twelve separate U.S. industry groups; for nine others, the import share of the

domestic market grew by one percentage point or less. Even more relevant, in 1982, imports accounted for more than 10 percent of the domestic market in only seventeen out of forty major industry groups, and in only six—TV sets and radios, shoes and leather, office equipment (excluding computers), motor vehicles, special industry machinery, and miscellaneous manufacturing—did they account for over 20 percent. "Naturally," the study notes, "the six are well publicized."

Trade and Protectionism

The revival of world trade last year, welcome as it was, took place against the background of continued and often increasingly protectionist measures by national governments, however. As in previous years, this "new" protectionism manifested itself largely in the guise of quantitative rather than price-related actions. Many newly taken measures were, in fact, limited to individual commodities, often from specific supplier countries, or involved bilateral agreements between two trading partners. To some extent, this shift from tariffs, in the form of published and fairly unequivocal schedules, to mainly nontariff barriers, including so-called safeguards, antidumping laws, and countervailing duties, has reinforced many countries' protectionist stance. As the IMF noted in its latest annual report on exchange restrictions: "The high degree of uncertainty about the invocation of these measures against a trading partner and the highly legalistic and political character of such decisions have made commercial policies particularly disruptive to the pattern of trade."

This trend toward reliance on quantitative controls and bilateral agreements has been particularly evident among the industrial countries. Moreover, such actions have been aimed not only at trade among themselves, but also at manufactured goods originating in the developing countries. A table in the World Bank's 1984 *World Development Report* shows the percentage of the major industrial countries' total imports affected by such nontariff barriers (the data reflect barriers in place in 1983, applied to 1980 import values). As the Bank notes, however, such data offer little basis for actual comparison, since the stricter a country's import restrictions are, the less it will actually import and the fewer its imports that are effected by such measures.

	Imports from	
	Industrial Countries	*Developing Countries*
Switzerland	22.6%	48.8%
France	20.1	7.1
Belgium	19.2	29.7
Japan	19.2	5.4
Netherlands	16.1	19.8
Austria	15.0	8.1
United Kingdom	14.9	14.3
United States	13.0	5.5
Germany	12.6	8.5
Italy	12.5	7.0

It has been stressed repeatedly that one of the chief victims of protectionism is the consumer who is faced by a smaller choice of available goods, at higher prices. Moreover, the consumer generally has the least clout in influencing the legislative process. In this connection, it is worth noting that a meeting at the OECD in late November will deal specifically with the interests of consumers in world trade.

Consumer organizations that will participate have said that this represents an attempt on their part to achieve what business and labor have long had, namely, a larger role in the decision-making process at the OECD, as well as at GATT and other international agencies concerned with trade matters. The conference reportedly will include workshops on the sectoral effects of various trade measures, and will also focus on the impact of nontariff barriers on specific consumer markets, as well as on strengthening the representation of consumer viewpoints in trade-related policy decisions.

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December 1984

FOREIGN CAPITAL EXPENDITURES BY U.S. COMPANIES
Continued Expansion in 1985

A decidedly expansionary mood exists among U.S. manufacturing companies in connection with their foreign capital expenditures in 1985. Approximately 43 percent of the companies responding to a survey in October 1984 plan to spend more in 1985 than in 1984. At the same time, the percentage of responding companies planning to spend less dropped. The proportion of companies planning to spend about the same did not change significantly

In the year 1985, consequently, a continuation is to be expected of the upswing in such expenditures that first became evident in the survey of a year ago. At that time, 34 percent of the respondents planned to spend more in 1984 than in 1983. This tendency was reinforced in the April, 1984 survey, also relating to the year.

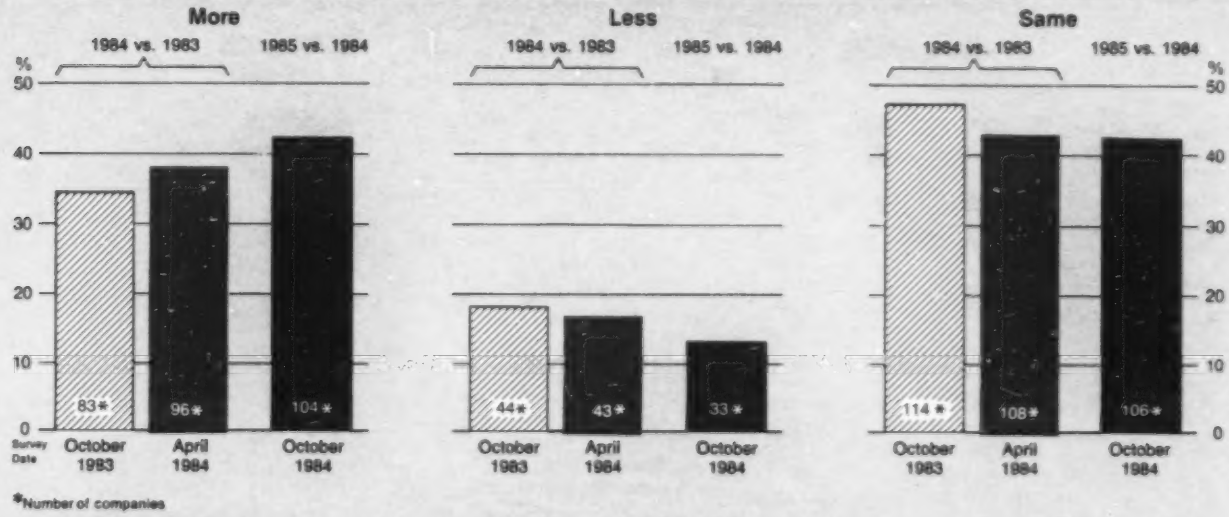
Despite two years of expansion, foreign capital expenditures in 1985 may come back only to the 1982 level. The survey conducted by The Conference Board is aimed at comparing the direction of current investment intentions with past levels on a company-by-company basis, without seeking dollar magnitudes. In the June, 1984, survey by the Department of Commerce (the latest aimed at estimating capital spending in dollars), manufacturers (including petroleum companies) stated that they expected to spend about $36.3 billion. If so, it would be slightly under the 1982 level.

In "real terms," 1985 spending will actually be well below the 1982 level. As global inflation has proceeded at rates of 13 percent in 1983 and 14 percent so far in 1984, general price levels are well above those in 1982 while expected capital expenditures just about match those of that year.

J. Frank Gaston

Manufacturers' Plans for Plant and Equipment Expenditures Outside the United States

Number and Percent of Companies Planning to Spend:



*Number of companies

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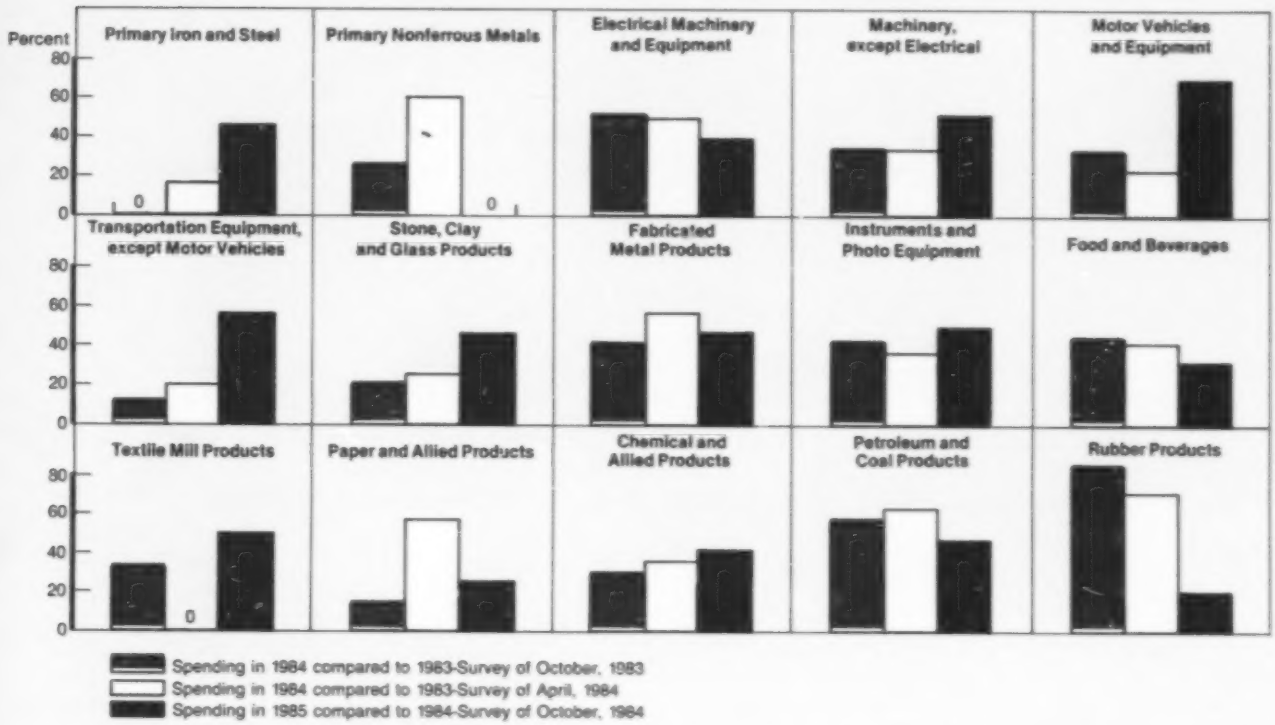
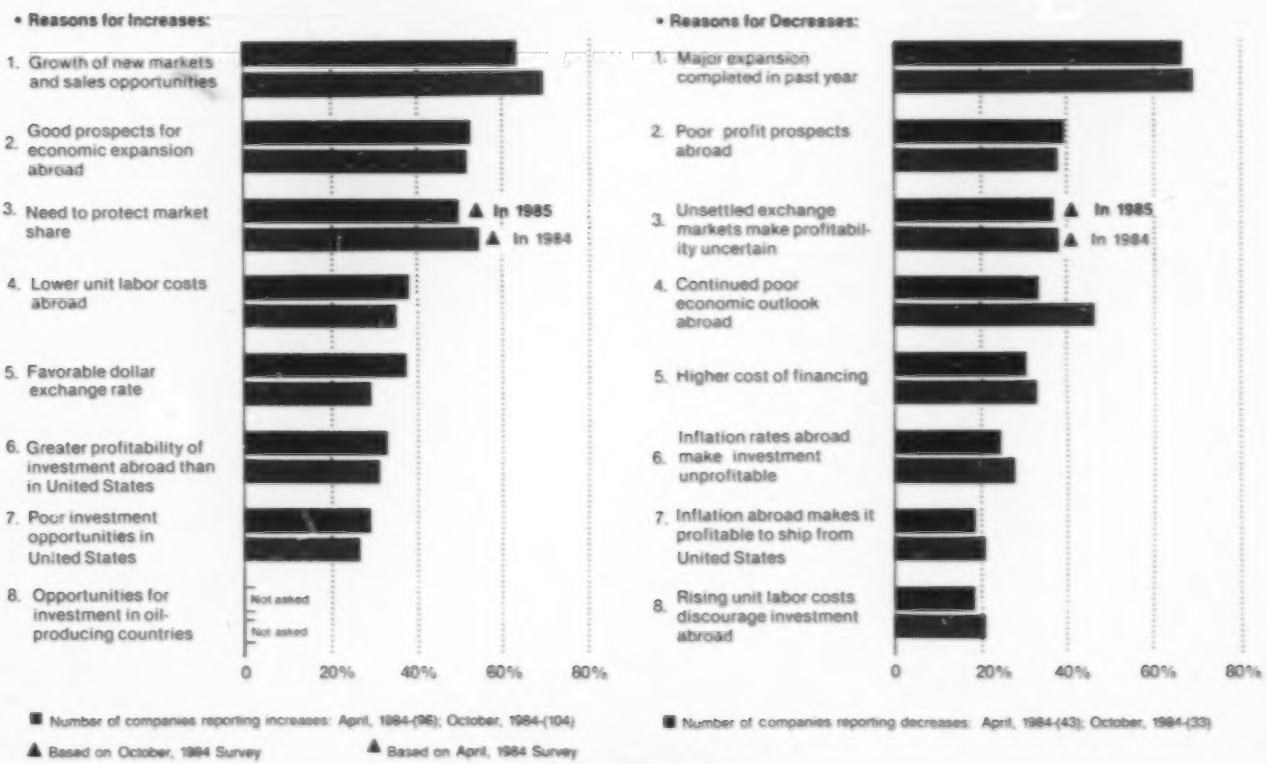
Spending Plans for Plant and Equipment Outside the United States by Industry

Percent of Companies Planning to Spend More



Reasons for Plant and Equipment Expenditures Outside the United States—All Manufacturing

■ ■ Percent of companies reporting


• Reasons for Increases:
1. Growth of new markets and sales opportunities
2. Good prospects for economic expansion abroad
3. Need to protect market share
4. Lower unit labor costs abroad
5. Favorable dollar exchange rate
6. Greater profitability of investment abroad than in United States
7. Poor investment opportunities in United States
8. Opportunities for investment in oil-producing countries
▲ In 1985
▲ In 1984
Not asked
Not asked
0
20%
40%
60%
80%
• Reasons for Decreases:
1. Major expansion completed in past year
2. Poor profit prospects abroad
3. Unsettled exchange markets make profitability uncertain
4. Continued poor economic outlook abroad
5. Higher cost of financing
6. Inflation rates abroad make investment unprofitable
7. Inflation abroad makes it profitable to ship from United States
8. Rising unit labor costs discourage investment abroad
▲ In 1985
▲ In 1984
0
20%
40%
60%
80%

■ Number of companies reporting increases: April, 1984-(96); October, 1984-(104)

▲ Based on October, 1984 Survey

▲ Based on April, 1984 Survey

■ Number of companies reporting decreases: April, 1984-(43); October, 1984-(33)

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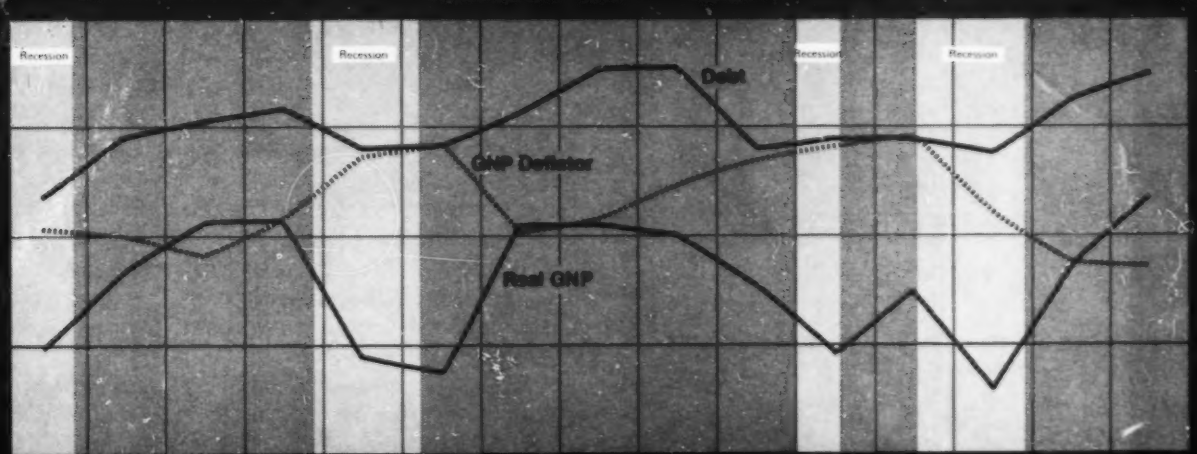
February 1985

CREDIT FLOWS AND THE U.S. ECONOMY: An Early Warning

There is a time bomb, slowly ticking away, that could pose a more serious long term problem for the United States economy than that posed by the well-publicized Federal Government deficit. The total debt of the so-called nonfinancial domestic sector of the U.S. economy (which includes that of the government) is growing more rapidly than the nation's Gross National Product in current dollars and, once again, is growing at rates that are likely to lead to high rates of inflation in future years. This problem is complicated by the fact that it is difficult to slow the growth of debt from double-digit rates without plunging the economy into a recession.

The problems that are likely to arise from the rapid growth of debt, like those that flow from the federal deficit, need not take place in 1985 or even 1986. Also, as in the case of the federal deficit, they can be avoided if appropriate actions are taken to help slow the growth of debt, not abruptly, but gradually, so as to avoid a sharp slowdown in real economic activity. In the past, sharp declines in the rate of growth of total debt have been followed by large declines in real economic activity, just as sharp increases in the total have been followed by an acceleration in the rate of inflation (see Chart 1). These changes in borrowing and U.S. economic activity have implications for the international flow of credit and, indeed, for economic activity in the rest of the world. According to the OECD, roughly 70 percent of the growth in the OECD countries in 1983 and 1984 originated in the United States.

The net expansion of debt in the United States, which proceeded more rapidly than the nation's GNP in 1983 and 1984, is, once again, expected to take place more



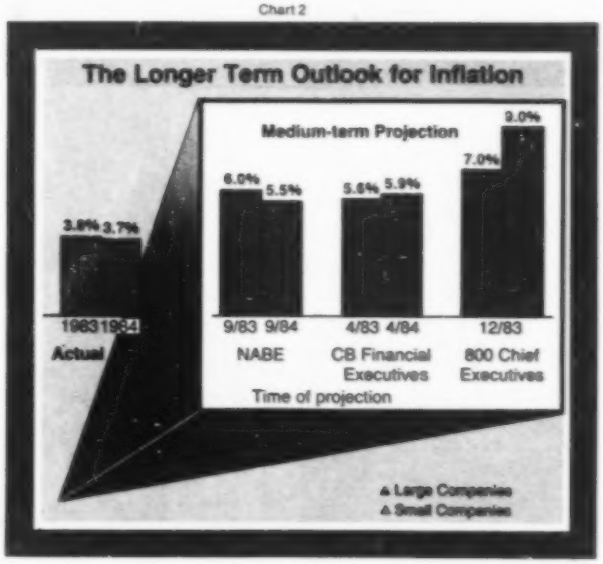
rapidly than GNP this year. The consensus forecast for the U.S. economy, as of early 1985, has shifted from one of below-average real growth (with a recession beginning later in 1985 or in early 1986) to one of approximately 3 percent real growth, with the rate of inflation generally expected to average around 4 percent. In short, the case for a "soft-landing" of the economy in 1985 now looks far more realistic than it did as little as one quarter ago. This outlook has been influenced by the reduction in the U.S. dollar price of oil and the continued strength of the dollar relative to other major currencies. The forecast of sustainable growth hinges on a continuation of a reasonably accommodative monetary policy.

It is a testimony to the strength of inflationary expectations that even after the severe recession of 1981-1982, long term interest rates on U.S. government securities did not fall into single-digit figures. The longer-term outlook for inflation remains well above the 3.7 percent actual rate of inflation of the U.S. economy in 1984.

According to Conference Board and other surveys, the longer term outlook for inflation ranges between an average of 5.5 percent to 9 percent (see Chart 2). Approximately 800 chief executives see rates of inflation averaging 7 to 9 percent, while a smaller group of senior financial executives looks for inflation to average nearly 6 percent over a five-year period. The lowest forecast of inflation comes from the economics profession: members of the National Association of Business Economists expect the rate of inflation to average 5.5 percent annually over the five-year period 1985-1989.

These estimates of inflation help to explain why long term interest rates are still in double-digit territory and also help explain part of the puzzle as to why so-called real interest rates (i.e., the money or nominal rate of interest adjusted for inflationary expectations) appear to

Chart 2



be at record high levels. Most adjustments to arrive at real rates of interest use the latest *actual* rates of inflation, rather than inflationary expectations taken from surveys and therefore overstate the resulting real rates of interest.

During the 1980's, many businesses increased their borrowings with the expectation that inflation would average 6 percent or more. In many areas involving important commodities, price increases have not been forthcoming for several years, and servicing debt, consequently, has become increasingly burdensome. While the expansion of debt should not be excessive, the prolonged difficulties in many sectors of the domestic and international economies provide limits of the extent to which the expansion can be slowed.

Increasing attention is being given to the limitations placed upon fiscal policy by the growth of interest payments on debt in the government sector. Interest payments by the United States Government will constitute over 13 percent of 1985 government expenditures and clearly restrict the scope of fiscal alternatives. Interest payments by the government sector as a percentage of GNP for the United States are slightly higher than they are in the case of Japan and the United Kingdom; but they are well below the percentages for Canada and Italy. The OECD anticipates that the United Kingdom will be the only major industrial country to have lower interest payments relative to its GNP in 1985 than in 1984. Debt interest payments by the government sector of the Federal Republic of Germany, however, are expected to remain the same (3 percent) in relation to that country's GNP (see Chart 3).

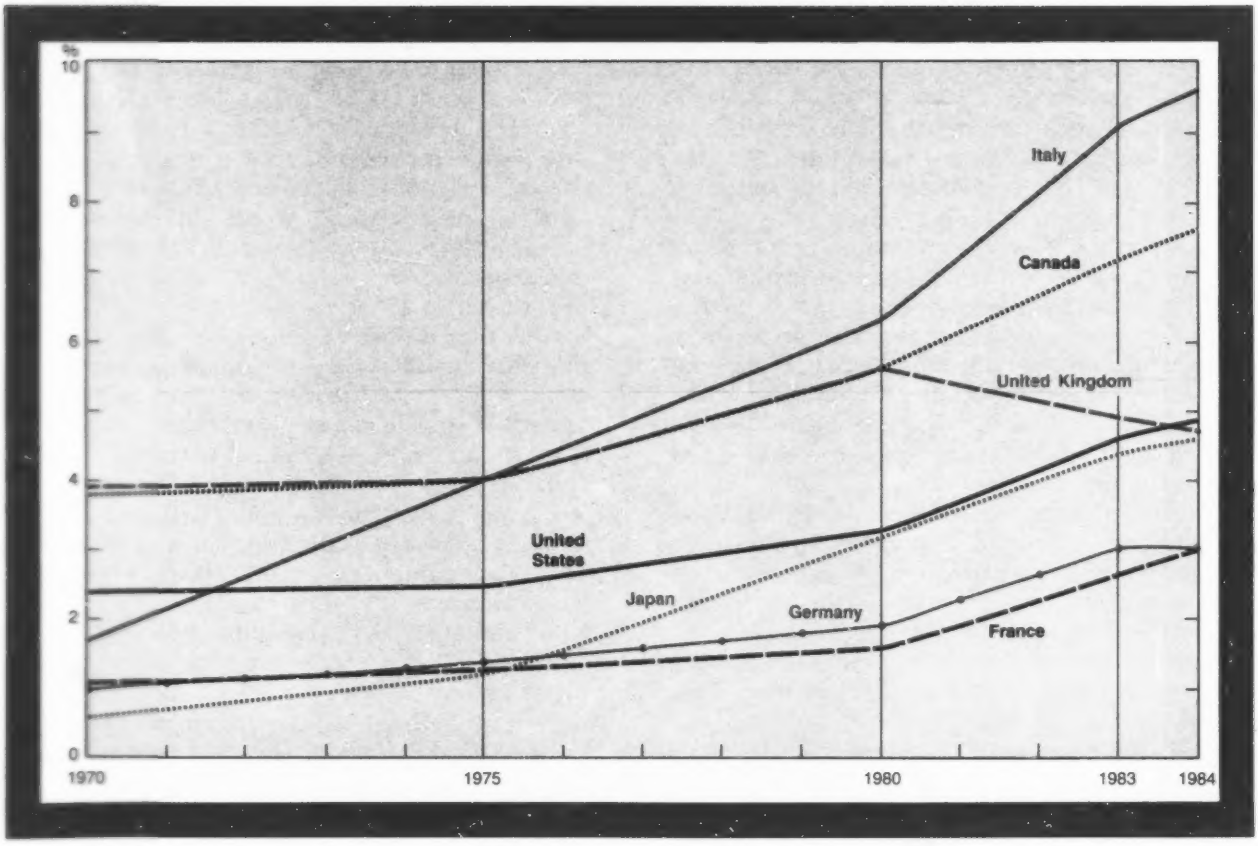
There is a more general point that applies to all sectors of the economy with respect to interest payments and the net flow of credit. Calculations by The Conference Board show that interest payments on the broader monetary aggregates (M2 and M3) would, by themselves, require each of these aggregates to grow at annual rates that would place them above the lower limits of their growth targets which, in both cases, is 6 percent. Similarly, interest payments pose lower limits for the growth of total debt as well as broader monetary aggregates. In 1984, interest payments amounted to approximately 75 percent of the net flow of credit to the domestic nonfinancial sector. In other words, a large part of the demand for credit, in effect, exists to meet interest payments which, for the most part, cannot be compressed or rescheduled. These figures help to show why a substantial reduction in the rate of growth of credit is likely to affect the real economy and can, if it takes place too abruptly, easily lead to a recession.

Since 1970, changes in the rate of growth of *private* domestic nonfinancial flows (i.e., total domestic credit less the net flow of U.S. government credit) have paralleled changes in real economic activity. The

Chart 3

Interest on Public Debt

As percentage of nominal GNP/GDP



economy's real growth, for instance, is most rapid when rates of growth of private credit are increasing and are doing so at high levels. Also, reductions in the rates of growth of credit of 2.5 percent or more have, in each case, accompanied each recession in the past fifteen years (see table).

Total credit and inflation have also been connected since 1970. Each time there has been an increase in the net flow of total domestic nonfinancial credit into double-digit rates, there has also been an acceleration in the rate of inflation—with a lag that can be as long as three years. Should the relationship between total credit and inflation continue to hold, the rate of inflation should start to accelerate in late 1985 or early 1986. As of early 1985, the U.S. economy was still experiencing the influence of the substantial reduction in the rate of growth of credit from 12.8 percent in 1978 into single-digit rates that ranged from 8.9 to 9.5 percent during the 1979-1982 period.

Aside from the issues posed by large changes in the growth of total debt, a key issue concerns the growth that

Table 1: Private Credit Demands and the Economy
(percent)

	Net Private Flow of Credit (Percent)	*Real Economic Activity (Percent)*
1970	7.7	-0.2
1971	10.0	3.4
1972	11.7	5.7
1973	12.9	5.8
1974	10.4	-0.6
1975	6.3	-1.2
1976	9.5	5.4
1977	13.1	5.5
1978	13.6	5.0
1979	13.5	2.8
1980	9.0	-0.3
1981	9.0	2.5
1982	6.4	-2.1
1983	9.4	3.7
1984	11.5*	6.8

*Estimated

Sources: The Conference Board based on the Federal Reserve and the U.S. Department of Commerce.

has taken place in the total debt of nonfinancial corporations. There are sharply different views in the financial community as to whether or not the additions to debt by nonfinancial corporations are taking place too rapidly. Those who argue that the financial strength of U.S. companies is weakening point to the deterioration in the many traditional measures of corporate liquidity (such as the ratio of liquid assets to current liabilities), the increase of short term debt as a percentage of total debt, and, finally, to the increasing percentage of total assets that is financed by debt.

Despite serious financing problems in a number of areas, there is little doubt that corporate earnings have improved substantially in recent years. Those who see a fundamental improvement in corporate financial strength point out that corporate cash flow reached a twenty-year high relative to the nation's GNP, providing companies with the means to finance their growing debt. Also, reported corporate profits are no longer "bloated" by inventory profits due to inflation.

There is another important development that could well point to a fundamental improvement in corporate financial strength. Many companies have taken steps to further improve productivity and to continue cost-cutting measures. Many have raised their returns on assets and are undertaking only those new investments that can clearly meet these higher returns. All of these developments are reflected in the fact that the number of companies whose debt was upgraded in 1984 exceeded those whose ratings were downgraded. A further upgrading in corporate credit ratings is expected in both 1985 and, on balance, in the second half of the 1980's.

Companies are looking for a substantial increase in long term debt in 1985. According to the latest financing calendar from Moody's, the total prospective financing of *industrial* corporations now amounts to $42.2 billion as compared to $21.2 billion at a similar date last year. Total prospective financing of all corporations—including financial companies, utilities and transportation companies—amounts to $78.7 billion as compared to $49.3 billion a year ago.

While there is divided opinion as to whether corporate financial strength has improved or deteriorated, it does not appear unreasonable to expect corporate credit demands to grow at double-digit rates in 1985. Since the credit demands of the government sector will also grow at double-digit rates in 1985, the growth of total credit will be well above that of nominal GNP in 1985. Since there is not much of a public mandate to win the battle over inflation through a debt deflation, it is likely that the U.S. economy will once again encounter substantially higher rates of inflation in the next several years, but rates that would still represent some improvement over the past five years.

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The Conference Board

Worldbusiness Perspectives No. 85
April 1985

U.S. FOREIGN TRADE IN 1984
America's Other Deficit

In recent years, the United States trade deficit has received as much publicity and generated as much debate as the much larger federal budget deficit. In both instances, the magnitudes that have been attained are unprecedented and their implications for both the U.S. economy and U.S. economic policy are complex.

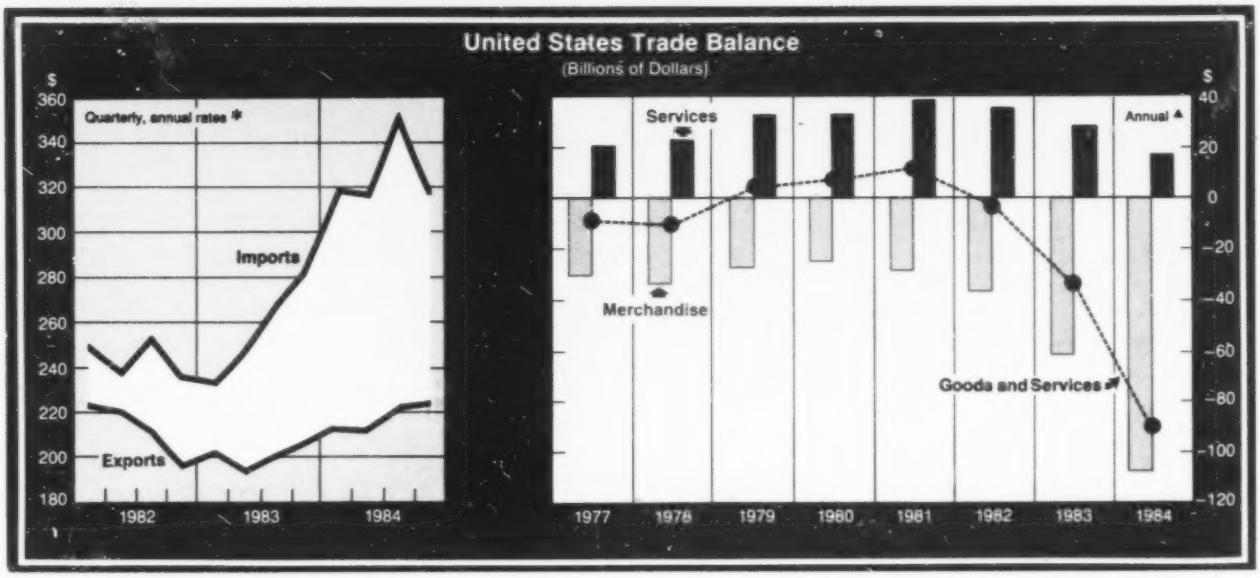
There are of course strong links between the two shortfalls. As Governor Henry Wallich of the Federal Reserve Board told the Swiss-American Society in Basel last December: "Rapid growth of economic activity, stimulated by a large budget deficit and favorable tax changes, has increased U.S. imports. The large budget deficit, by raising dollar interest rates, has caused the dollar to appreciate, further stimulating imports."

Tallying 1984

The U.S. trade deficit ballooned to $107.9 billion last year, from $57.6 billion in 1983. (If imports are valued on the so-called c.i.f. basis, which includes insurance and freight, the results were $123.3 billion and $69.4 billion, respectively.) This sharp deterioration can be analyzed under a number of different aspects.

- In terms of the overall statistics, last year's was the largest trade deficit this country has ever incurred. In fact, the deficit by itself was larger than total U.S. foreign trade (exports and imports combined) had been as recently as 1972. While both exports and imports increased—following two years of *declining* exports—import growth, at 26.2 percent, was triple the export expansion, of 8.7 percent. This represented the sharpest annual growth in import value since 1974, the year oil prices quadrupled.

- As regards major categories, the deficit on trade in manufactures deteriorated to $78.4 billion from $31.0 billion in 1983. The deficit on petroleum and petroleum products increased slightly (after a decline in 1983), as imports rose to 5.5 million barrels a day from 5.1 million in 1983.



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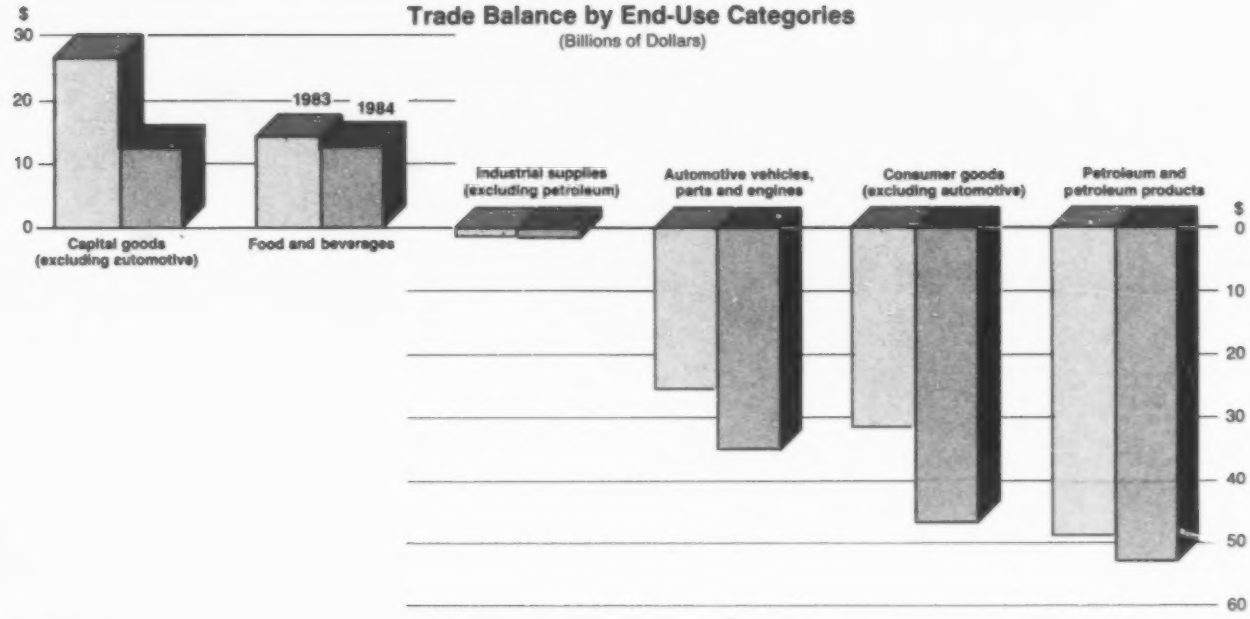


• On a geographic basis, Canada and Japan together accounted for roughly half of the global deficit last year. About half of the $33.6 billion deficit with Japan reflected automotive trade alone. Moreover, an estimated $4 billion of the deficit on such trade has been attributed to shipments of more expansive Japanese cars to the United States under the voluntary quotas (which lapsed on March 31).

• The sharp deterioration in the U.S. trade accounts also contributed to a marked worsening of the overall U.S. international position. As recently as 1981, the U.S. balance of payments on current account had recorded a $4.6 billion surplus as the trade deficit was more than offset by large services earnings, mainly income on foreign investment. But the slower pace of the recovery abroad as well as the strong dollar lowered foreign earnings, so that the services surplus shrank to $17 billion from $28 in 1983. This, combined with governments payment abroad, resulted in a current-account deficit of $102 billion.

• The worsening of the U.S. external position also had a negative effect on domestic economic activity. That position enters into the national accounts as "net exports of goods and services." (Because of various adjustments, that figure does not correspond to the balance on goods and services in the chart on page 1.) Over the past few years, large changes in "net exports" have reduced the rate of increase, or added to the rate of decline, in total GNP (see tabulation). Thus, last year the drop in net exports reduced the rate of increase in GNP by almost two percentage points.

	Percent change in		
	Gross national product	*Gross domestic purchases**	*Difference*
1982	*−2.1*	*−1.4*	*−0.7*
1983	*+3.7*	*+4.9*	*−1.2*
1984	*+6.8*	*+8.7*	*−1.9*

** GNP − exports + imports of goods and services*

• The sharp increase in the trade deficit has had adverse effects on both export and import-competing industries which, as Federal Reserve Chairman Paul Volcker remarked last year, "have not shared at all proportionately in the recovery." The conventional wisdom is that each $1 billion of trade deficit costs the U.S. economy some 25,000 manufacturing jobs. A recent study by Data Resources has indeed estimated that the rise in the dollar since 1980 has produced a cumulative deficit of some $60 billion above what it would otherwise have been and hence has led to a loss of 1.5 million jobs in manufacturing. Another half million jobs were estimated to have been lost in argiculture and services.

U.S. Trade and Economic Activity Abroad

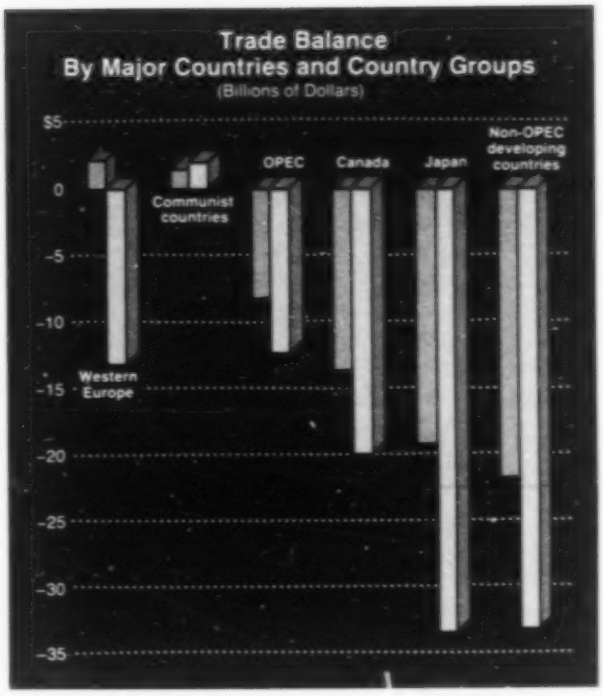
The causes of the large U.S. trade deficit go beyond the sharply higher dollar, however. Differences in both the timing and strength of the economic recovery in the United States and the other industrial countries played a major role in the 1983 deficit and continued to influence last year's results.

Recovery from the 1981-82 recession began in November 1982 in the United States, but, according to the Center for International Business Cycle Research at Columbia

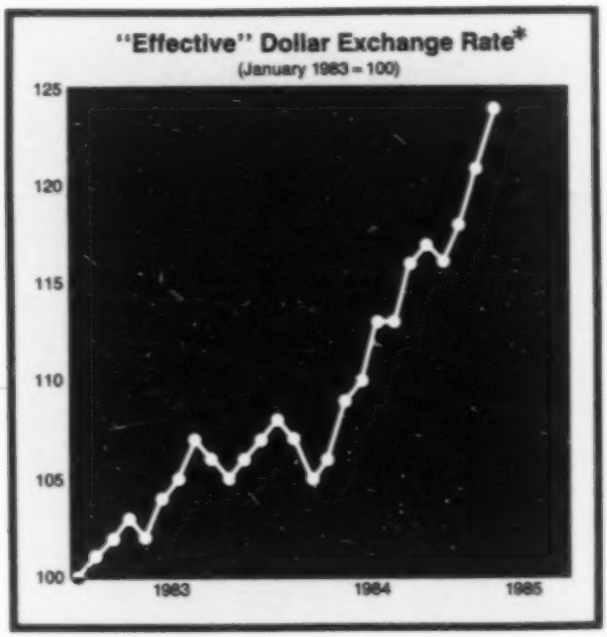
University, did not begin until June 1983 in Japan and the United Kingdom and until July in Germany. Moreover, while the U.S. economy grew by 3.7 percent in 1983, the GNP of four other major industrial countries grew only between 1.75 and 3.25 percent and actually declined in France and Italy. This "continued recession or lackluster recovery," as the Commerce Department characterized it, was a major factor in the 1983 trade deficit.

While all the major economies showed renewed growth last year, their performance still remained uneven and below the 6.8 percent recorded by the United States. Thus, for the six other major industrial countries that join the United States in the annual economic summit 1984 GNP growth ranged from 1.75 percent for France to 5.75 percent for Japan. For the ten nations of the European Community combined, last year's growth came to 2.4 percent.

Slower growth in much of the industrial world continued to have an indirect effect on U.S. trade with many developing countries, which found some of their traditional export markets less buoyant. Moreover, the export surpluses that many of those countries need to service their debts call for deficits for their trading partners. The burden of running such a deficit, it was recently pointed out, falls almost entirely on the United States. For the first 11 months of last year, the U.S. deficit with major debtor nations accounted for about 15 percent of the overall deficit. In 1980, by contrast, the United States had run a small surplus, of some $290 million, with those same countries. Since debt repayments, under recent reschedulings, call for a protracted period of debtor-country trade surpluses, the U.S. deficit with that part of the world is likely to increase for the rest of this decade.



Finally, the continued decline in oil prices cut the effective import demand of OPEC countries further last year.



* Dollar rate vis-a-vis 15 major currencies, weighted by bilateral manufactures trade in 1980.

Dealing With U.S. Trade Issues

The strong dollar and the resulting loss in U.S. international competitiveness have, predictably, increased the calls for protectionist measures. More protectionist proposals have in fact been introduced in the past four years than under any administration in the previous 40 years. The most publicized of these include local-content legislation for all cars sold in the United States and a 20 percent import surcharge.

In addition to such bills, a number of broad reforms have recently been proposed aimed at strengthening the government's decision-making system when dealing with the problem of U.S. international competitiveness. Several of these proposals would forge closer links between domestic and international policymaking. A prototype of this thinking is the bill to establish a new Department of International Trade and Industry (DITI) that would combine the functions of the U.S. Trade Representative and the international elements of the Department of Commerce.

Other bills would supplement existing mechanisms with boards or commissions to draft adjustment plans and consider protection for affected industries. Under one such

proposal, the International Trade Commission would create a board consisting of both industry leaders and cabinet officials that would recommend reductions in excess capacity, technological improvements, new product development, and management and productivity changes. All such activities would be exempt from antitrust legislation. Still other proposals look for some form of tripartite advisory council representing labor, business and government, with regional or sectoral subcouncils.

All such proposals raise a number of important questions. For instance, should an advisory board or council be autonomous or part of the Federal structure? Should such a body take mainly a long-term view or should it, in the words of the *Harvard Business Review,* "focus instead on putting out fires more efficiently?" And, perhaps most important, how much power of enforcement would such a body have to be given in order to be effective? If one talks about recommending changes and restructuring at the industry or corporate level—in brief, what in Europe and Japan goes under the rubric of "industrial policy"—then one raises the even broader question of the proper role of government in the conduct of business.

A more far-reaching approach to dealing with U.S. trade and international issues emerged from the report of the President's Task Force on International Private Enterprise, released last December. The report recommends that the Executive Branch establish an Economic Security Council that "would parallel the National Security Council in its advisory and operating capacities, raising economic policy issues to a level comparable to that of international political issues."

Such a body would set governmentwide guidelines for all actions in the international economic sphere, make sure that the ramifications of domestic policy actions for this sphere are taken into account, and coordinate preparations for the annual economic summit meetings. The group, moreover, would analyze such issues as the effect of economic sanctions against a foreign country on our own industry and agriculture; the repercussions on the dollar, and hence on U.S. foreign trade, of our domestic monetary policy; and the effect of domestic regulations such as antitrust and environmental legislation on the ability of U.S. industries to compete with foreign firms. Another issue on the Council's agenda would be the application of U.S. laws and regulations beyond our own borders, which discourages some U.S. companies from doing business abroad.

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Worldbusiness Perspectives No. 86
June 1985

FOREIGN CAPITAL EXPENDITURES BY U.S. COMPANIES
Unchanged Expectations for 1985

Investment abroad in plant and equipment abroad by manufacturers appears to be on a steady course, according to the latest survey of The Conference Board. Approximately 42% of those replying to the April 1985 survey indicated that they planned to spend more abroad than in 1984. This is virtually the same response as for the October 1984 survey about 1985 expectations.

The same stability showed up in the percentages of those expecting to spend the same and those expecting to spend less: nearly identical responses in both categories over the last two surveys.

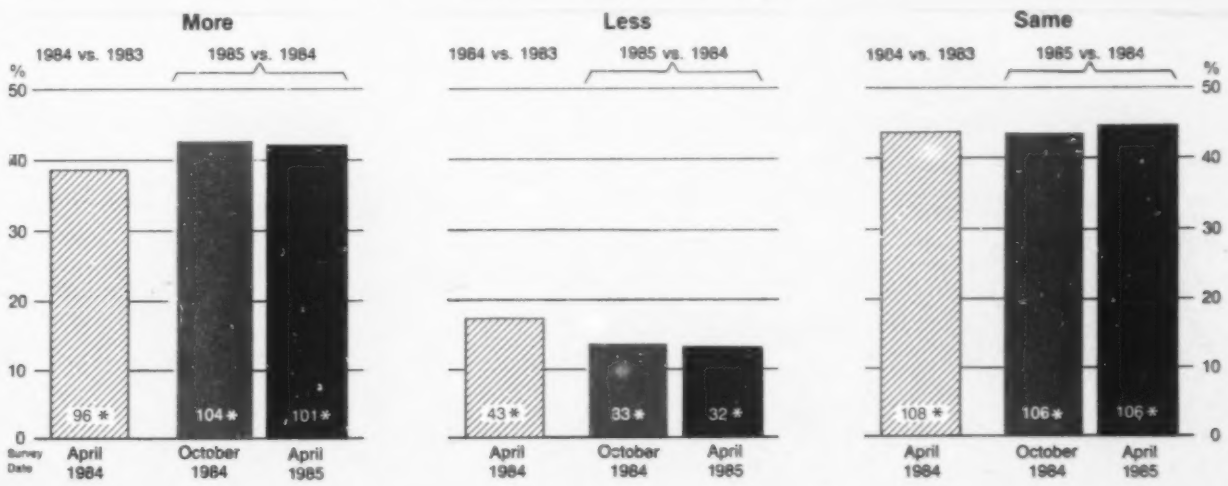
It is too early to tell what these responses signify for total money expenditures. Certainly it appears that 1985 expenditures will be larger than those of 1984, which in turn were above those of 1983. But it appears that the experience of early 1985 does not seem to have created any major change in outlook for capital expenditures.

In December of 1984, the Department of Commerce estimated from survey data that manufacturers (including petroleum companies) anticipated spending $35.0 billion on plant and equipment outside the United States in 1985. The more recent Conference Board survey does not point to any subsequent change in intentions. If that is true the 1985 total will still be below the record-high dollar levels of 1982, after two years of expanding expenditures, the major part probably due to inflation.

J. Frank Gaston

Manufacturers' Plans for Plant and Equipment Expenditures Outside the United States

Number and Percent of Companies Planning to Spend:



*Number of companies

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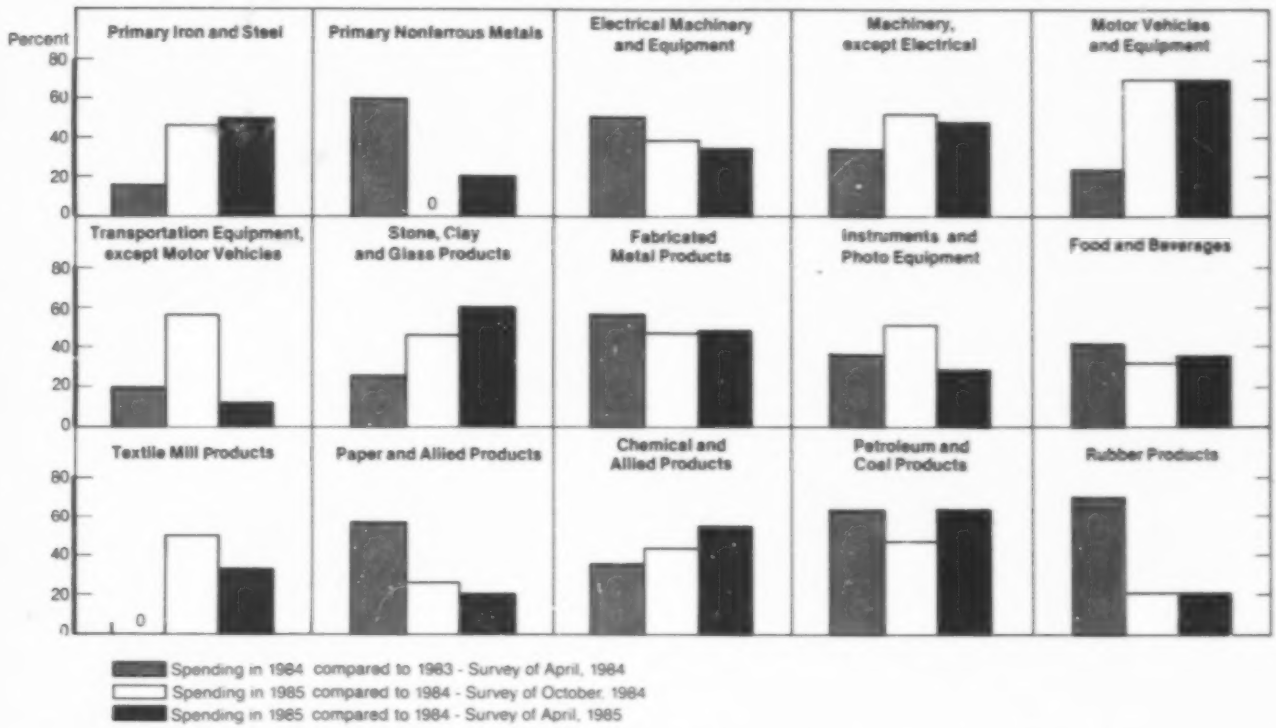
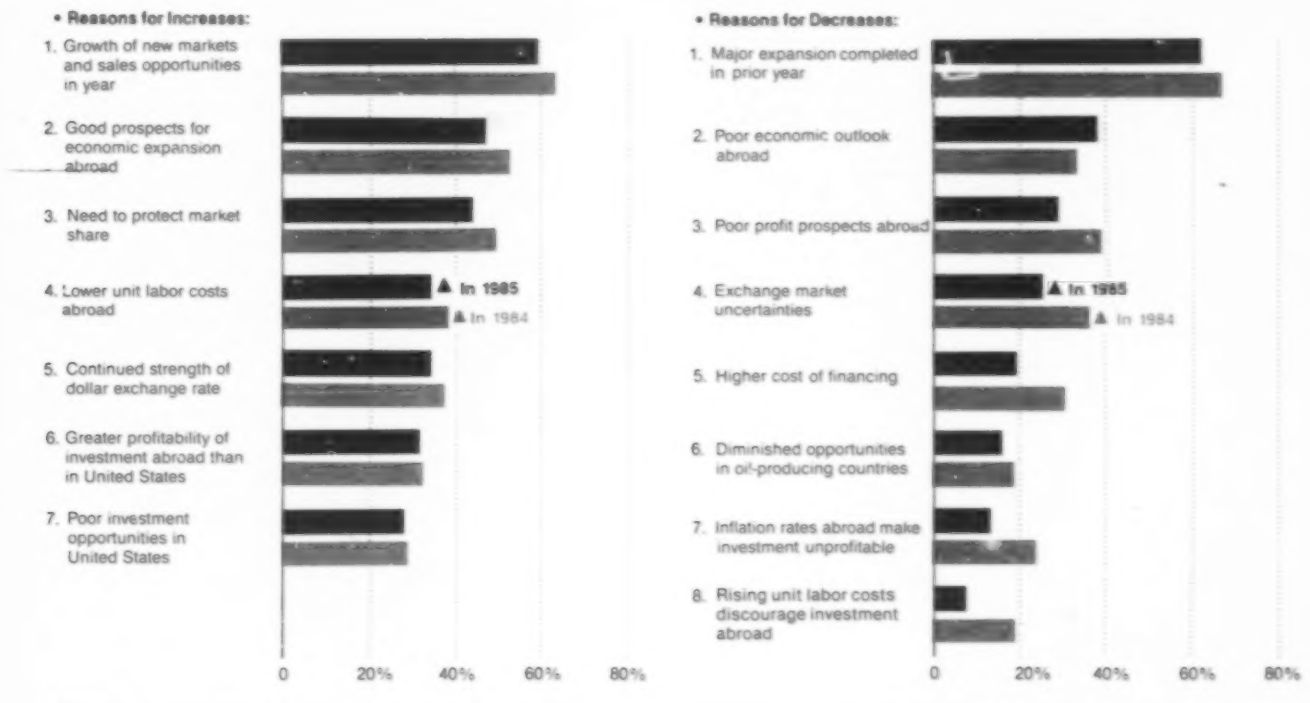
Spending Plans for Plant and Equipment Outside the United States by Industry

Percent of Companies Planning to Spend More



Reasons for Plant and Equipment Expenditures Outside the United States—All Manufacturing

■ ■ Percent of companies reporting


• Reasons for Increases:
1. Growth of new markets and sales opportunities in year
2. Good prospects for economic expansion abroad
3. Need to protect market share
4. Lower unit labor costs abroad
5. Continued strength of dollar exchange rate
6. Greater profitability of investment abroad than in United States
7. Poor investment opportunities in United States
▲ In 1985
▲ In 1984
0
20%
40%
60%
80%
• Reasons for Decreases:
1. Major expansion completed in prior year
2. Poor economic outlook abroad
3. Poor profit prospects abroad
4. Exchange market uncertainties
5. Higher cost of financing
6. Diminished opportunities in oil-producing countries
7. Inflation rates abroad make investment unprofitable
8. Rising unit labor costs discourage investment abroad
▲ In 1985
▲ In 1984
0
20%
40%
60%
80%

■ Number of companies reporting increases: October, 1984 (104); April, 1985 (101)

▲ Based on April 1985 Survey

■ Number of companies reporting decreases: October, 1984 (33); April, 1985 (32)

▲ Based on October, 1984 Survey

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August 1985

FOREIGN INVESTMENT IN THE UNITED STATES
- The Year of the Japanese

Japanese manufacturing companies sharply increased the number of their plant constructions and expansions in the United States during 1984. That activity offset declines by Canadian and most European countries, whose transactions last year were significantly below the levels reached in 1979, when foreign investment as measured by The Conference Board reached its peak.

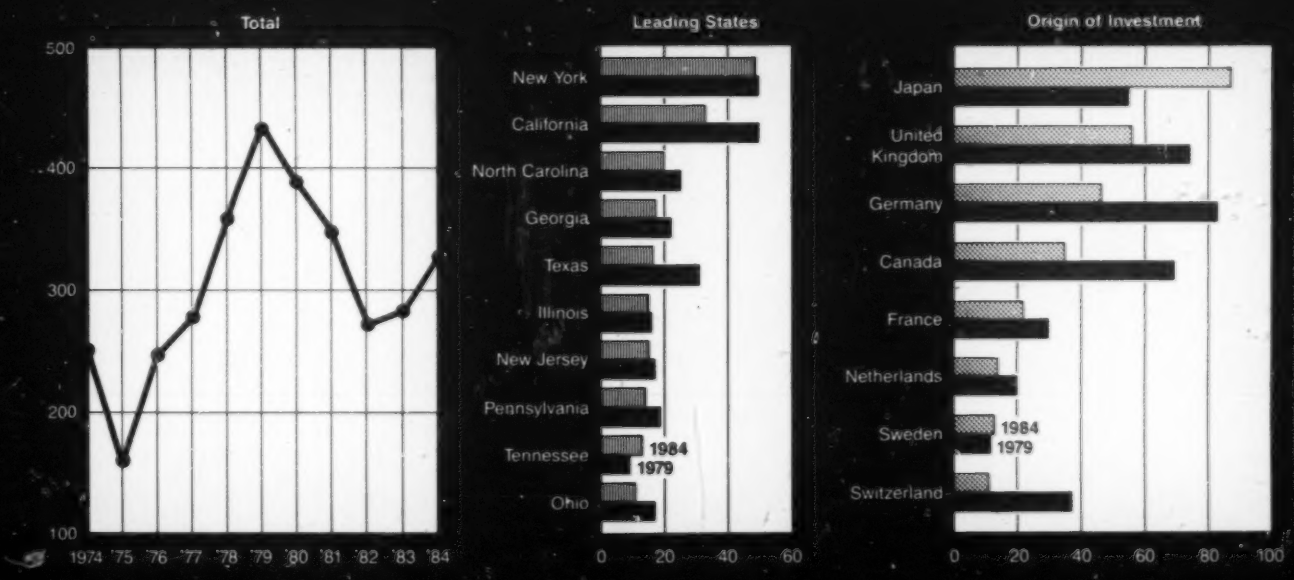
In cumulative value—as opposed to number—Japan's manufacturing investments remain below those of most other industrial nations, despite last year's gain. However, massive investments in other sectors, such as wholesale trade and banking, combine to make the aggregate value of Japanese direct investment in this country higher than all other industrial nations except England and the Netherlands.

The Japanese Expansion

The number of investments anounced by all foreign manufacturing companies during 1984 was 325, compared with 280 in 1983 and 271 in 1982. Last year was the first in which Japanese investments out numbered those from any other country, and by a substantial margin.

The number of investments by Japanese companies was 87, followed by 56 from the United Kingdom, and 46 from Germany. Canada, France and the Netherlands accounted for 35, 22 and 14 respectively.

Number of Foreign Investments in U.S. Manufacturing



Several factors explain the recent surge by the Japanese. The decision by Honda, Toyota and Nissan to establish U.S. manufacturing facilities prompted similar actions by many of their suppliers. Besides wanting to continue existing sales to the major Japanese automobile producers, these supplies also saw a chance for increased sales to U.S. car and truck manufacturers.

Of course, the establishment of U.S. production plants was forced to some extent by the "voluntary" agreements to limit Japanese exports to the United States. And the impact of these restraints spread far beyond the transportation industry. Among many Japanese producers of consumer goods, industrial machinery and electronic parts, the decision to produce in the United States stemmed partly from fears that the "voluntary" measures presaged an imposition of quotas.

Many Japanese companies also found that the size of their operations here already made U.S. production facilities a natural step. In some cases, U.S. companies purchasing Japanese-made parts and components became wary about depending on a foreign supply source, and urged their Japanese suppliers to establish plants in this country. In other cases, Japanese companies decided that their U.S.-based staff of sales and administrative personnel, engineers and research technicians had expanded to the point where manufacturing in the United States was necessary and logical.

Other factors include the relative abundance of industrial sites and energy supplies (particularly oil) in the United States.

With some important exceptions, the same factors motivated both Japanese and European investment in this country. The bulk of Japanese investments, however, has occurred during the past 6-10 years. But while many European companies accelerated their investments during the past decade, most initiated U.S. operations in the 1950's. Thus, Japanese plant and equipment investments are distinguished by how rapid their massive buildup has been.

Japanese Investment Strategy

A decade age, the Japanese opted to build new plants rather than purchase U.S. companies. Exceptions were Japanese companies purchasing their U.S. distributors and sales agents, often as a prelude to establishing manufacturing operations. New plants are still preferred: in 1984, roughly 80% of Japanese investments consisted of construction projects, while the comparable figure for all other companies was 60%. There is evidence, however, that Japanese companies are becoming more willing to acquire U.S. companies or enter into large-scale, joint ventures with U.S. firms. Japanese firms have recently acquired U.S. firms producing industrial chemicals, motors, apparel, ventilating equipment, and ball bearings. The latter acquisition,

Minebea's purchase of New Hampshire Ball Bearing Inc., underwent U.S. government review before completion.

Some of the larger joint ventures last year included the one between Toyota and General Motors, Toshiba's agreement with Westinghouse and Sharp's joint venture with RCA. The Toyota-GM venture comes after Honda and Nissan decided to manufacture in this country. Toshiba's and Sharp's arrangement to produce television tubes and electronic components with U.S. firms will expand existing operations. Last year Japanese firms also ventured into new areas, including some that have had difficulty in attracting new capital from domestic sources.

The largest of these new areas is steel. Before 1984, although Japanese steelmakers exported to the United States, they produced little here other than at a small mill in Auburn, New York. But in 1984, five of the six largest Japanese steel producers spent more than $500 million, according to some estimates, to form joint ventures with U.S. companies as well as purchase U.S. facilities. Well over this sum represents Nippon Kokan's $292 million purchase of 50% of National Steel Corp., a unit of National Intergroup Inc.

Other investments include Nisshin Steel's and Mitsubishi's joint venture with Wheeling Steel to build a $50 million plant in West Virginia, and Kawasaki's purchase of partial interest in a California mill. Several objectives lay behind these investments, including realizing profits by fusing Japanese techonology with U.S. production operations and avoiding trade barriers on imported steel.

The growth of Japanese companies may well continue at a relatively rapid rate, at least in the short run. The number of investments announced for the first six months of 1985 approximates last year's rate. And a recent survey by the Japan Trade Organization indicates that nearly 40% of the Japanese companies currently in the United States plan to expand their production capacity.

Some observers, however, have suggested that Japanese profit levels both in this country and elsewhere are not buoyant enough to finance continued rapid growth. U.S. subsidiaries of Japanese manufacturing companies had a negative rate of return in 1983, and a return of under 1% in 1984. But others believe that investment by Japanese companies who are intent on expanding production capacity to supplement—or, in some cases, reduce—U.S. export sales will continue to suport high levels of capital outlays.

Investments from Other Countries

As noted, in 1984 the number of investments by Canadian and most European countries was near or below—in most cases, substantially—the levels reached in 1979. Only Australia and Sweden, countries, with relatively small investment positions in this country, posted about as many investments in 1984 as in 1979. Investment from the developing countries continues to be relatively small, accounted for primarily by the U.S. operations of Formosa Plastics (Taiwan), and the South Korean firms Gold Star, Hyundai and Samsung.

While the *number* of Canadian and European investments is declining, partial Conference Board data (as well as Department of Commerce tabulations) indicate that their *value* is growing. Recent increases stem primarily from the sizable sums spent to acquire U.S. companies. During the past 18 months, BASF of Germany announced that it would pay $1 billion for Inmont Corp.; Nestle of Switzerland acquired both Carnation Co. and CooperVision for approximately $3.4 billion. The value of these acquisitions plus two others—First City Industries of Canada bought Scovil and ICI bought the chemical business of Beatrice Cos.—totaled $5.6 billion. That net sum is not far below the estimated value of all 434 investments (plant construction as well as acquisitions) recorded during 1979. Thus the decline in the number of investments misrepresents the flow of investment capital into this country.

Investment by State

The geographical distribution of foreign investment has not altered radically during the past 18 months. Still, some areas of the country are beginning to draw foreign companies away from states that have traditionally attracted the largest number of investments. California, long a favored site of the Japanese, clearly benefited from the 1984 inflows; it attracted 33 investments in 1984 (compared with less than 20 for both both 1983 and 1982). Yet California is facing growing competition from Washington and Oregon, which together drew 12 investments last year, much more than in preceeding years. Several of these investors were firms who voiced objections to California's unitary tax system. Public officials of both Washington and Oregon also put on aggressive marketing programs.

New York continues to attract the largest number of foreign companies. Its 49 investments in 1984 include a number of Canadian firms making relatively modest investments in rented manufacturing facilities, but also more substantial transactions such as the $100 million joint venture between Toshiba and Westinghouse.

North Carolina ranked third in 1984 with 20 investments, followed by Georgia (17), Texas (16), New Jersey and Illinois (15 apiece), Pennsylvania (14) and Tennessee (13). Georgia and Tennessee are states whose access to national markets and supply of nonunion labor have attracted foreign companies. Both states have also recruited actively.

Although many states have developed outreach programs to attract investment—the Japan Economic Institute reported in May of this year that Connecticut became the 27th state to establish offices in Japan—there is no consensus about the benefits of investment flows to the U.S. economy. Some analysts feel that the inflow of investment capital makes U.S. employment and income levels vulnurable to corporate strategies formulated abroad. Others feel that the inflow of capital is accompanied by an outflow of technology and R&D expertise. Still, few if any state officials would argue for an outright ban on foreign investment. Most proposals at the federal level to limit investment have been muted to avoid possible retaliation by countries that already host substantial sums of U.S. corporate investments. But the growing foreign presence—not only in manufacturing but also other sectors such as banking and real estate—concerns some governors and other elected officials.

Investments by Industry

Foreign chemical producers announced more U.S. investments last year than any other industry. The 62 chemical investments far exceeded the 45 in electrical machinery, 42 in nonelectrical machinery, 25 in food products, 23 in stone, clay and glass, and 21 in transportation equipment.

Outlays by European companies explain almost all of the investments in chemicals. Japanese chemical firms, whose U.S. holdings are dwarfed by those of companies like Shell, ICI, Bayer, BASF and others, announced only nine investments last year and eight in 1983.

Major chemical investments last year included ICI's purchase of the chemical operations of Beatrice Cos. (mentioned above), as well as Ciba-Geigy's $100 million expansion of its New Jersey pharmaceutical complex.

(Shell's $5.67 billion purchase of Shell Oil and its Shell Chemical Co. subsidiary is not included in the Board's tabulations becase the parent company owned a controlling interest prior ot the purchase of the remaining shares.)

In the machinery industry, investments in nonelectrical machinery declined slightly during 1984. Offsetting this was a sharp rise in investments for producing electrical equipment (including electronic components). Japanese firms were responsible for much of this gain. Investments to produce stone, clay and glass products soared last year, in part because foreign cement producers now own about 35% of U.S. production capacity in that industry. Cement imports more than doubled between 1983 and 1984, and domestic producers are comparing trends in their industry to those in steel and autos.

Investment by Sector

The value of all foreign investment in this country was $160 billion at the end of 1984, according to the Department of Commerce. The 1984 figure was 17% above the the previous year, a gain that in large measure can be traced to the strength and durability of the U.S. economic recovery as well as a low inflation rate.

Department of Commerce data on investments are not directly comparable to those of The Conference Board. Commerce data include all investments that give the foreign company control of 10% or more of the U.S. subsidiary. The Board's ratio is 50%. Additionally, Conference Board data indicate the year in which the investment is announced; Commerce data relates to the year in which the investment is financed.

Manufacturing investments account for 35% of all direct investments in this country according to the most recent Commerce data, compared with 40% in 1980. The relative decline is attributable largely to a reduction in the value of Canadian holdings. Although Canadian investments increased last year, in prior years several companies shifted their ownership in U.S. subsidiaries from Canadian firms to affiliates in the Netherlands. Additionally, in recent years the U.S. subsidiaries of some Canadian companies recorded negative rates of return, and the absence of reinvested earnings reduced the value of investments.

Wholesale trade accounts for 15% of total investment, followed by petroleum (16%), real estate (9%), banking (6%), insurance (6%). While the share of Japanese investments has climbed rapidly (if erractically) during the past 10 years, the single largest concentration of their investments went to the wholesale sector. Largely because of sizable commodity holdings by their Japanese trading companies, Japanese firms own over 40% of the $24 billion foreign investment in wholesale trade.

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